LEE OIL PROPERTIES, INC., ET AL.

IBLA 83-957 Decided March 13, 1985

Appeal from a decision of the New Mexico State Office, Bureau of Land Management, canceling acquired land oil and gas lease offer NM-A 53482 (OK).

Set aside and remanded with instructions.

1. Oil and Gas Leases: Competitive Leases -- Oil and Gas Leases: Known Geologic Structure

   Where production is had under a state spacing order which would be attributable on a pro rata basis to Federal mineral interests within the spacing unit, such production prima facie establishes that the Federal land is within a known geologic structure of a producing oil and gas field, even where the United States has not consented to the communitization of the Federal interests pursuant to the state spacing order.
2. Oil and Gas Leases: Bona Fide Purchaser -- Oil and Gas Leases: Cancellation

   The protection afforded by 30 U.S.C. § 184(h)(2) (1982) to a bona fide purchaser of an oil or gas lease which issued noncompetitively applies only where the predecessors-in-interest were in violation of some provision of the Act, such as the acreage limitations. It does not apply where the lease was erroneously issued for lands not subject to noncompetitive leasing.
3. Oil and Gas Leases: Bona Fide Purchaser -- Oil and Gas Leases: Cancellation

   Where the assignee of an oil and gas lease is chargeable with actual or constructive knowledge of the fact that the lease improperly issued, the assignee may not assert bona fide purchaser status pursuant to 30 U.S.C. § 184(h)(2) (1982).

4. Oil and Gas Leases: Cancellation

> Where it is shown that an oil and gas lease which improperly issued embraces lands presently known to contain valuable deposits of oil or gas, the Department may not, consistent with 43 CFR 3108.3(e), administratively cancel such lease, but, rather, must commence suit in Federal court to obtain a judicial cancellation of the lease.

APPEARANCES: William D. Sinclair, vice president, Lee Oil Properties, Inc., for appellants.

OPINION BY ADMINISTRATIVE JUDGE BURSKI

Lee Oil Properties, Inc. (Lee), and May Petroleum, Inc. (May), have appealed from a decision of the New Mexico State Office, Bureau of Land Management (BLM), dated August 5, 1983, canceling acquired lands oil and gas lease, NM-A 53482 (OK).

Noncompetitive oil and gas lease offer NM-A 53482 (OK) was filed over-the-counter by Lee, on June 1, 1982, describing 4.06 acres of land in sec. 35, T. 27 N., R. 9 W., Indian Meridian, Oklahoma. Together with the application, Lee submitted a copy of a Division Order Title Opinion which indicated that the United States owned a 50-percent mineral interest in the subject tract, which was, at that time, unleased. The lease offer was accompanied by a $75 filing fee and advance annual rental in the amount of $2.03. By decision of November 3, 1982, the New Mexico State Office rejected the application because of a rental deficiency in excess of 10 percent, as provided by 43 CFR 3103.3-1 (1982) (now 43 CFR 3103.2-1(a) (1983)).

What next transpired is not totally clear. The record would indicate that Lee submitted an additional $2.03 on November 24, 1982. On January 20, 1983, the State Office "rescinded" its decision of November 3, 1982, presumably on the theory that appellant had cured the deficiency. In point of fact, however, Lee was still short 94 cents (more than 10 percent) since the annual rental is $1 per acre or any fraction thereof. See 43 CFR 3103.3-2(c) (1982) (now 43 CFR 3103.2-2(b) (1983)).

In any event, the lease offer was then processed. A statement was obtained from the District Supervisor, Minerals Management Service, that the land was not within a known geologic structure of a producing oil and gas field (KGS) on December 21, 1982. The subject lease issued on January 26, 1983, with an effective date of February 1, 1983. On March 15, 1983, May filed a request for approval of the assignment of 100-percent record title interest from Lee to May. This request was approved on May 11, 1983, retroactively effective to April 1, 1983. See 43 CFR 3106.7-4. As of the date of the approval of the assignment there was no indication in the lease file that anything was amiss.

Unfortunately, prior to the filing of oil and gas lease offer NM-A 53482 (OK), the land described therein had been the subject of another

offer. Key to understanding the genesis of the problems in this case is the realization that the parcel of land involved is within the boundaries of the Kegelman Air Force Base. Without going into a lengthy recitation of the difficulties which beset the Department in leasing lands in military reservations following the adoption of section 12(a) of the Federal Coal Leasing Amendments Act of 1976, Act of August 4, 1976, 90 Stat. 1083, as amended, 30 U.S.C. § 352 (1982), suffice it for our purposes to note that, pursuant to a notice published in the Federal Register on July 20, 1981 (see 46 FR 37205), a simultaneous filing period was established for the acceptance of oil and gas lease offers for acquired lands within military reservations. The 15-day period so established ran from August 16 to August 28, 1981.

Pursuant to this notice, Champlin Petroleum Company (Champlin) filed an offer, serialized as NM-A 48874 (OK), embracing, inter alia, the subject parcel, denominated Tract 10. Since the offer embraced acquired land under the jurisdiction of another executive department, it was necessary to obtain the consent of the United States Air Force prior to issuance of the lease to Champlin. See generally Joseph C. Manga, 71 IBLA 187 (1983). Accordingly, on June 14, 1982, BLM requested a title report from the Air Force. On March 30, 1983, the Air Force responded that the United States owned 50 percent of the mineral interests in Tract 10, but agreed to its leasing only on the condition that it be subject to a no-surface-disturbance stipulation and that directional drilling be made subject to the approval of the Commander, Vance Air Force Base. By decision of May 23, 1983, the New Mexico State Office afforded Champlin 30 days to sign the special stipulations requested by the Air Force. Champlin subsequently signed the requested stipulations. On July 15, 1983, BLM requested a KGS report from the BLM District Manager in Tulsa, Oklahoma.

By memorandum dated July 27, 1983, the District Manager informed the State Office that Tract 10, which was sought in lease application NM-A 48874 (OK), was already included in active lease NM-A 53482 (OK). Thus alerted to the problem, BLM proceeded to cancel oil and gas lease NM-A 53482 (OK) on August 5, 1983. BLM based its decision on the fact that it had failed to obtain the consent of the Air Force prior to leasing the land and the fact that Champlin had filed its application prior to the filing made by Lee, and thus issuance of the lease to Lee could not be sustained. Lee timely took an appeal.

It is apparent from our recitation of the subsisting factual milieu of this case that it was clear error for BLM to issue the lease to Lee in derogation of the rights of an applicant with higher priority and absent the approval of the Air Force. 1/ But, as we shall show, the matter is considerably more complex than that.

1/ We expressly reserve the question whether, in a case involving acquired lands under the jurisdiction of another agency, issuance of a lease prior to obtaining the consent of the agency could be cured nunc pro tunc by the subsequent consent of the agency to lease. The instant appeal presents so many additional problems that favorable resolution of this simple issue would not alter the ultimate result. Accordingly, we will not examine this question further.

In its statement of reasons, Lee makes the following argument:

> Lee Oil Properties, Inc. was issued the captioned oil and gas lease February 1, 1983. Inasmuch as this lease was issued, Lee Oil Properties, Inc., assumed that all regulations had been adhered to. Lee Oil Properties, Inc. did not have knowledge that the Department of the Interior did not have consent from the acquiring agency as provided for in the regulations of Title 3109.3-1. Lee Oil Properties, Inc. did not have knowledge of lease offer NM-A 48874, made by Champlin Petroleum Company. Lee Oil Properties, Inc. acquired the captioned lease on behalf of May Petroleum, Inc. May Petroleum, Inc. has drilled the Zaloudek No. 1 located in Section 35-27N-9W. The Zaloudek No. 1, which is on 640 acre spacing is producing from the Mississippi formation. Inasmuch as May Petroleum, Inc. assumed they owned the captioned oil and gas lease, they have paid all drilling costs that would be attributed to this interest. The cancellation of this lease would not be in the best interest of Lee Oil Properties, Inc. or May Petroleum, Inc.

Appellant's argument effectively raises two separate points for consideration. First, if May purchased the lease for value without actual or constructive knowledge of any underlying deficiency, is its lease protected from cancellation by the bona fide purchaser protection afforded by 30 U.S.C. § 184(h)(2) (1982)? Second, to the extent that the subject parcel contains lands known to be valuable for oil or gas, would the provisions of 43 CFR 3108.3(c) apply so that cancellation of such a lease would require "judicial proceedings in the manner provided in sections 27 and 31 of the [Mineral Leasing] Act"? 2/ Because of its broad ramifications, we will explore this latter consideration first.

In support of its allegations concerning the drilling of Zaloudek No. 1 well, appellant has submitted a copy of the completion report submitted to the Oklahoma Corporation Commission. The subject well was drilled in the center of the NE 1/4 of sec. 35. This report shows that the well was completed on September 10, 1981, and the first production occurred on September 22, 1981. This well was, therefore, completed prior to the issuance of the lease to appellant. Moreover, it was drilled pursuant to Oklahoma Corporation Commission Order No. 179804, dated November 21, 1980, which had established all

2/ It is arguable whether, in the absence of this regulation, recourse to judicial proceedings would be necessary to cancel a lease known to be valuable for oil or gas for pre-lease errors in issuance. Thus, in Boesche v. Udall, 373 U.S. 472 (1963), the Supreme Court clearly ruled that section 31 of the Mineral Leasing Act, as amended, 30 U.S.C. § 188(a) and (b) (1982), "reaches only cancellations based on post-lease events and leaves unaffected the Secretary's traditional authority to cancel on the basis of pre-lease factors." Id. at 478-79 (emphasis in original). However, the Department has, by regulation, interpreted the scope of the Secretary's authority to administratively cancel leases as being limited to those not known to contain oil or gas. See generally James W. Smith, 6 IBLA 318, 79 I.D. 439 (1972).

of sec. 35 as a single drilling and spacing unit for production from various formations, including the Mississippi Lime. Thus, under the order of the Oklahoma Corporation Commission pro rata production is allocable to the Federal mineral interests. 3/

The following issues are thus brought into focus. First, since the Zaloudek No. 1 well was producing prior to lease issuance, it is difficult to ascertain why the land was not KGS'd. The Conservation Division Manual of the Geological Survey provides

> [w]hen a tract of Federal land has been determined to be capable of, or presumptively capable of, producing oil or gas in commercial quantities, the land must be formally described as a KGS. Production, or a presumptive capability of production, is established by: (1) the completion of a producing well on or near the Federal land; (2) the inclusion of previously nonproducing Federal land in the participating area of a unit agreement or a producing communitization agreement; and (3) geological or drilling data which renders the reasonable inference that a producible reservoir extends under the land in question.

Conservation Division Manual 620.3.6E. In elaborating on point 2, the manual expressly notes that "any Federal lands that are subject to a communitization agreement that is in production, or secondary recovery unit, must be in a KGS." Id.

It is true that, technically, the Federal mineral interest was not (and, apparently, has not been) communitized. This is because the State Corporation Commission lacks authority, absent the consent of the Federal Government, to forcibly pool the mineral interests of the United States. See generally Kirkpatrick Oil & Gas Co. v. United States, 675 F.2d 1122 (10th Cir. 1982); Kirkpatrick Oil & Gas Co., 15 IBLA 216, 81 I.D. 162 (1974). Thus, the United States would have no claim to its pro rata royalty until such time as a communitization agreement had been submitted to it and approved. 4/ It might, therefore, be argued that since the production from the Zaloudek No. 1 was not attributable to Tract 10, the land was not subject to being KGS'd by reason of that well's successful completion. Inferentially, this might also lead to the conclusion that the land within lease NM-A 53482 (OK) was not known to contain valuable deposits of oil or gas and, thus, is subject to administrative cancellation.

3/ This point was expressly made in the Division Order Title Opinion which appellant had submitted with its lease application. Thus, on page 21, the Title Opinion noted that proceeds attributable to the 50 percent mineral interest of the United States in Tract 10 (therein described as "Tract 2") should be suspended.

4/ Communitization agreements are often retroactively approved with an effective date coinciding with first production. See, e.g., Bruce Anderson, 80 IBLA 286, 91 I.D. 203 (1984). Normally, however, where a new lease is involved, a communitization agreement may not be effective prior to the date of lease issuance, though, if all parties agree, it can be made effective prior to first production, even though such date is prior to the effective date of the lease. See Conservation Division Manual 645.3.3C.

[1] We conclude, however, that, even though the United States has failed to consent to communitization of its mineral interests pursuant to a State spacing order, where production is had under the State order which would be attributable on a pro rata basis to the Federal mineral interest, such production prima facie establishes that the Federal land is within a KGS of a producing oil or gas field and is, accordingly, only subject to competitive leasing. Our conclusion is grounded in the realization that, in those rare situations where BLM (or its predecessor in these determinations, the Geological Survey) has refused to assent to State spacing orders, the refusal has not been premised on the view that the pool did not underlie the tract in question, but rather revolved around the issue as to what spacing would maximize efficient recovery of the pool. Thus, in Kirkpatrick Oil & Gas Co., supra, the Department refused to accede to 640-acre spacing (normally deemed suitable for a gas field) where production indicated that the field was more properly classified as an oil field which would be amenable of a smaller spacing unit. 5/ That decision clearly was not premised on a view that the oil field did not underlie the Federal tract since, in point of fact, the producing well was located on Federal land.

Effectively, the key distinction is between Federal approval of a communitization agreement (which establishes the legal basis upon which royalties may properly be prorated) and the existence of geological facts which can serve as a basis for a KGS determination. We hold that where production is had under a State drilling unit, which unit includes Federal lands or lands in which the Federal Government has a mineral interest, such production is sufficient to establish the presumptive productivity of the Federal lands, even in the absence of a federally approved communitization agreement. Since, as we have noted many times, a KGS includes all lands "presumptively productive" (see, e.g., Jack J. Bender, 40 IBLA 26 (1979), rev'd on other grounds, 744 F.2d 1424 (10th Cir. 1984), such lands are properly KGS'd.

There is, however, another element necessary in the determination of a KGS, namely, consideration of when the information upon which the ultimate KGS determination is based became available to the responsible departmental official. See Skelly Oil Co. v. Morton, No. 74-411 (D.N.M. July 18, 1975). As the New Mexico District Court noted in Skelly, the date of ascertainment of a KGS is when the officials of the Department become aware of the facts necessary to establish the KGS. In this regard, however, we note that appellant submitted with his application a Division Order Title Opinion. Such an opinion is prepared at the request of a purchaser of oil or gas anticipatory to the preparation of a Division Order under which the purchaser would tender payment in the proportions set out in the order. The specific order involved herein clearly established that there was production under the state spacing unit. As discussed above, knowledge of this fact was, of itself, sufficient to cause all lands in the spacing unit to be KGS'd. Thus, the knowledge necessary to support a KGS classification was acquired by BLM simultaneous to

5/ The instant case presents virtually the same fact situation though, as far as we can ascertain, no communitization agreement was ever submitted to the Department for approval. Thus, the well is classified as an oil well, yet the Oklahoma Corporation Commission has provided for 640-acre spacing.

the filing of appellant's lease offer. Hence, we find that not only was the instant lease issued to a junior offeror without first obtaining the necessary consent of agency, but it was also issued noncompetitively in violation of 30 U.S.C. § 226(b) (1982).

[2] There is, of course, an ancillary question whether May, as the assignee of Lee, was a bona fide purchaser for value within the meaning of 30 U.S.C. § 184(h) (1982). Such a claim must be rejected for two independent reasons. First, as we noted in Oil Resources, Inc., 14 IBLA 333 (1974), the bona fide purchaser provision provides protection to "good faith purchasers whose predecessors in interest were in violation of some provision of the act, such as acreage limitation provisions, and not for protection of purchasers of leases erroneously issued for lands not subject to noncompetitive leasing." Id. at 337 n.1. Thus, where it can be determined that "the date of ascertainment" of a KGS was prior to the date of lease issuance, such a noncompetitive lease is a nullity and a bona fide purchaser cannot be afforded the statutory protection of 30 U.S.C. § 184(h) (1982). See also William L. Ahls, 85 IBLA 66 (1985).

[3] Second, even were we to assume that May could make recourse to the bona fide purchaser provisions, it would be unable to bring itself within their ambit. In Winkler v. Andrus, 614 F.2d 707 (10th Cir. 1980), the Court reiterated the requirements of bona fide purchaser protection, viz., that the bona fide purchaser must have acquired his interest in good faith, for valuable consideration, and without notice of the violation of Departmental regulations. Id. at 711. Quite apart from the question whether bona fide purchaser protection is available where the lease is initially acquired by an agent of the ultimate assignee, 6/ the fact is that May is the operator of the Zaloudek No. 1 well and, therefore, had actual knowledge of its producing status and the fact that production was allocated to Tract 10. Knowing these facts, May would also be properly charged with constructive knowledge that Lee's lease could not properly have issued noncompetitively. Thus May did not, as a matter of law, acquire the lease without knowledge of the fact that it had improperly issued, even though it may have been unaware of the existence of Champlin's senior offer or of the failure to obtain the approval of the Air Force prior to lease issuance.

[4] There remains, however, the determination of whether the subject lease is "known to contain valuable deposits of oil or gas" such that the Department may not administratively cancel the lease. We recognize, of course, that the mere fact that a land may be within a KGS does not, necessarily, establish that it is known to contain valuable deposits of hydrocarbons since KGS classification merely establishes the limits of presumptive productivity. See generally James W. Smith, supra at 325 n.7, 79 I.D. at 443 n.7. But where, as here, production is effectively allocated to the Federal tract we think it clear that such land must be deemed to be known

6/ Thus, Lee states that it "acquired the captioned lease on behalf of May Petroleum, Inc." In light of the other considerations which necessitate rejection of May's bona fide purchaser assertion, we need not decide whether and in what circumstances the existence of an agency agreement between the assignor and assignee might defeat an attempted assertion by the assignee of bona fide purchaser protection.

to be valuable for oil or gas within the contemplation of 43 CFR 3108.3(e). This being the case, the State Office lacked authority to administratively cancel the lease. Rather, the correct course of action is to request the Department of Justice to commence suit in Federal court seeking a judicial cancellation of lease NM-A 53482 (OK).

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is set aside and the case files are remanded with instructions to refer the matter to the Justice Department for initiation of judicial proceedings to cancel lease NM-A 53482 (OK).

James L. Burski
Administrative Judge

We concur:

R. W. Mullen
Administrative Judge

Edward W. Stuebing
Administrative Judge